



MAJOR TAX RELATED MEASURES

Passed by the Twenty-First Legislature
Regular Session of 2001

8/15/01

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Overview

- Selected measures affecting Hawaii's tax laws
- Copies of acts available from:
 - House and Senate Printshops
 - Download from capitol website at:
www.capitol.hawaii.gov
- For more information, visit DOTAX website at:
www.state.hi.us/tax, and select "Recent Legislation"
 - Detailed information on selected legislation
 - List and brief summaries of current legislation
 - Links to the text of bills both enacted and vetoed



Administrative Tax Measures

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ACT 44 — EFT

(S.B. 1192)

- Repeals 2% penalty for failure to pay by EFT when the taxpayer is not required to pay by EFT but has nonetheless elected to participate in the EFT program
- Example:
 - Taxpayer who is not required to pay by EFT but who has elected to pay by EFT pays by check on or before the due date instead of by EFT.
- Effective April 26, 2001

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Removes a disincentive for those opting to pay by EFT.



ACT 45 — Confidentiality

(S.B. 1195, S.D.1)

- Extends to ALL taxes administered by the DOTAX under title 14 the confidentiality privileges previously available only under the income tax law for communications between a taxpayer and any federally authorized tax practitioner including:
 - Attorneys
 - CPAs and Accountants
 - Enrolled Agents and Enrolled Actuaries
- Applies to taxable years beginning after December 31, 2000

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Confidentiality privilege enacted as part of IRC conformity bill during the 2000 Legislative Session – Act 174, SLH 2000 – Conforms with IRC section 7525.

Extends attorney-client privilege to certain communications between TP and other tax practitioners.

Deletes references to IRC section 7525 in chapter 235 and adds new language in chapter 231, Administration of Taxes.

NOTE: The privilege extends to tax advice only; it does not cover work papers used to prepare a return. Also does not apply to criminal cases.



ACT 206 — Mainland Contractors

(H.B. 407, H.D.1, S.D.1, C.D.1)

- Ensure mainland contractors pay the GET on federal construction projects in Hawaii
 - Directs DOTAX to continue working with the federal government, local businesses and the labor community to enforce collection;
 - Requests assistance from the federal government;
 - Authorizes Tax Director to contract with bonded collection agencies, licensed attorneys, accountants, auditors, and others to pursue unpaid taxes; AND
 - Requires report to legislature re future legislation needed.
- Effective June 2, 2001

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ACT 270 — Cigarette Tax Stamp

(S.B. 992, S.D.2, H.D.2, C.D.1)

- New special funds
- Reduction of 0.4% of the denominated value of the stamp to compensate licensees for the costs of affixing tax stamps; adjusted by administrative rule
- Prohibits resales of cigarettes purchased at military sales outlets
- Presumes that all cigarettes are subject to the tax
- Allows AG access to certain tax records
- Effective June 22, 2001, w/provisos

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New special funds are:

Cigarette tax stamp enforcement special fund

Tobacco enforcement special fund

Cigarette tax stamp administrative special fund

Provisos:

0.4% reduction in the cost of tax stamps from \$1.017 to \$1.013 per stamp eff. 9/1/01.

Appropriations out of special funds and appropriations out of general funds and into the cigarette tax stamp enforcement special fund & cigarette tax stamp administrative special fund effective 7/1/01.



General Excise/Use Tax Measures

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ACT 125 — Nonprofits

(S.B. 1193, S.D.1, H.D.1, C.D.1)

- Streamlines the exemption application process for certain nonprofit organizations
 - Organizations described in IRC section 501(c)(3), (4), (6), or (8) that are recognized or that have applied for recognition by the IRS as tax-exempt
 - Subordinate organizations that have received a group exemption letter from the IRS
- Allows the DOTAX to extend the time for filing an exemption application for good cause
- Effective July 1, 2001

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New Form: G-6S - Application for Exemption From General Excise Taxes (Short Form) now available for qualifying nonprofit organizations.

Deletes the 2-month limitation on extensions for filing exemption applications.



ACT 164 — Aquaculture

(S.B. 1264, S.D.2, H.D.2)

- Amends subsections 237-4(a)(6) and (7) re wholesale sales to licensed producers to also include the sale of seedstock and aquacultural products
- Effective July 1, 2001

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This is a clarification of the law.



ACT 210 — Aircraft Leasing

(H.B. 1685, H.D.1, S.D.1, C.D.1)

- New GET exemption for amounts received as rent for the leasing of aircraft or aircraft engines used by the lessee for interstate air transportation
 - Exemption applies whether the lease is an operating lease or a financing lease.
 - Interstate air transportation means the same as in 49 U.S.C. 40102.
- Expands the use tax exemption for leased aircraft
- Effective July 1, 2001

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Interstate air transportation as defined includes interisland flights.



ACT 221 — High Tech

(H.B. 175, H.D.2, S.D.2, C.D.1)

- New GET and PSC exemption for public Internet data centers
 - Applies to gross income and gross proceeds of sales received after June 30, 2001 but not after December 31, 2005
- New GET exemption for sale of net operating loss by a qualified high technology business
 - Effective January 1, 2001
 - Shall be repealed on December 31, 2005

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Public Internet Data Centers:

Public Internet Data Centers are defined as facilities available for compensated use by the public and designed to:

- House data servers;
- Operate on a 24-hour, 7-day-a-week basis;
- Have redundant systems for electricity, air conditioning, fire suppression, and security; and
- Provide services such as bandwidth, co-location, data backup, complex web hosting, and aggregation for application service providers.

Sales of NOLs:

The sales of unused NOLs by a QHTB was enacted last year as part of Act 297, SLH 2000. This provision codifies the DOTAX's position that such a sale would be a "casual sale" not subject to the GET.

Other provisions of Act 221 will be discussed later.



ACT 221 — High Tech

(Continued)

- Amends §237-23.5 re the GET exemption for certain services furnished by one related entity to another to also include:
 - The use of computer software and hardware;
 - Information technology services; AND
 - Database management services.
- Applies to gross income and gross proceeds of sales received after June 30, 2001

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Definition now reads as follows:

“Services” means legal and accounting service, the use of computer software and hardware, information technology services, database management, and those managerial and administrative services performed by an employee, officer, partner, trustee, sole proprietor, member, or manager in the person’s capacity as an employee, officer, partner, trustee, sole proprietor, member or manager of one of the related entities and shall include overhead costs attributable to those services.



Income Tax Measures

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ACT 36 — Hearing Impairment (S.B. 264, S.D.1)

- Allows an audiologist licensed under chapter 468E to certify the hearing impairment of an individual
- Applies to taxable years beginning after December 31, 2001
- Forms Changes:
 - Form N-172 (Revised 2001)
 - Form N-857 is obsolete
 - New Form G-65 (Disability Deduction Worksheet)
 - New deduction method to effect the 0.5% tax rate
 - Special Instructions for Disabled Taxpayers (6/91) is obsolete

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An individual certified as “deaf” (a person whose average loss in the speech frequencies – 500-2000 Hertz – in the better ear is 82 decibels, ASA, or worse) and other individuals certified as blind or permanently disabled may claim certain tax benefits.

Income Tax:

Individual taxpayers may claim a \$7,000 personal exemption amount in lieu of the \$1,040 regular personal exemption and \$1,040 additional exemption for taxpayer age 65 or older (\$7,000 exemption may not be claimed by a taxpayer for a dependent who is blind, deaf, or permanently disabled).

General Excise Tax:

Individuals and corporations all of whose shareholders are certified as blind, deaf, or permanently disabled, may claim an exemption from gross income of \$2,000, with the remainder of their gross income taxed at a maximum rate of 0.5%.

Previously, only a qualified otolaryngologist could certify the level of hearing impairment.

Forms Changes:

Form N-172 (Rev. 2001) - Combines Form N-857 (completed by doctor to certify the disability) and Form N-172 (to notify DOTAX of eligibility). Persons who previously filed Form N-857 and N-172 with the DOTAX do NOT need to be re-certified.

Form G-65 - Deduction method ensures timely processing of returns.



ACT 119 — \$1 Tax Credit

(S.B. 699, H.D.1)

- Constitutionally mandated refundable income tax credit of \$1 per exemption excluding additional exemptions for being age 65 or older
 - Required whenever the state general fund balance at the close of each of 2 successive fiscal years exceeds 5% of general fund revenues for each of the 2 fiscal years.
- Credit claimed on 2001 individual income tax returns on or before the end of the twelfth month following the close of the tax year (December 31, 2002)
- Effective May 18, 2001

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Per article VII, section 6, of the Constitution of the State of Hawaii.

Provision enacted by the 1978 Constitutional Convention

Requirements:

1. Claimed by Hawaii residents who are not claimed or eligible to be claimed as a dependent by another taxpayer for federal or Hawaii purposes even though they do not have any gross income to report.
2. Person for whom the credit is claimed must have been a Hawaii resident for at least 9 months during the calendar year (but they don't have to be physically present in Hawaii).

Credit NOT Available to:

1. A person convicted of a felony and confined in prison for the full taxable year;
2. A person otherwise eligible to be claimed as a dependent but who has been committed to and resided in a youth correctional facility for the full taxable year; OR
1. A misdemeanor confined in jail for the full taxable year.



ACT 199 — IRC Conformity

(S.B. 854, S.D.1, H.D.1)

- Conforms to certain federal income tax changes enacted during 2000
 - Community Renewal Tax Relief Act (P.L. 106-554)
 - Installment Tax Correction Act of 2000 (P.L. 106-573)
- Some significant changes conformed to:
 - Increase in the low-income housing tax credit cap and other changes to the credit (IRC §42(d), (h), (i), and (m)(1))
 - Extension and modification of the enhanced charitable deduction for corporate donations of computer technology (IRC §170(e)(6))

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Hawaii law generally conforms to subtitle A, chapter 1 and certain 6000 series sections of the IRC of 1986 as amended.

A complete digest of these acts with respect to sections operative and inoperative for Hawaii income tax purposes may be found on our website. See Announcement No. 2001-13.



ACT 199 — IRC Conformity

(Continued)

- Significant changes conformed to (cont.):
 - Extension of the medical savings account program through 2002, and renaming medical savings accounts (MSAs) as Archer MSAs (IRC §220(d), (i), and (j))
 - Expansion of the definition of a lump-sum distribution (IRC §401(k)(10)(B)) for purposes of IRC §401(k)(10) to permit distributions of an annuity contract from a qualified plan or an IRC §403(a) to be lump-sum distributions
 - Upon the termination of a plan OR
 - Upon the disposition by a corporation of its assets or its interest in a subsidiary

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ACT 199 — IRC Conformity

(Continued)

- Significant changes conformed to (cont.):
 - Repeal of subsection (a) of the Ticket to Work and Incentives Improvement Act which disallowed the installment method of accounting for accrual basis taxpayers
- Applies to tax years beginning after December 31, 2000
- No Hawaii earned income tax credit provision

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ACT 221 — High Tech

(H.B. 175, H.D.2, S.D.2, C.D.1)

- New 4% nonrefundable income tax credit for renovation costs incurred after December 31, 2000, to provide a commercial building in Hawaii with technology-enabled infrastructure
 - For taxable years beginning after December 31, 2000, but not for taxable years beginning after December 31, 2005
 - “Renovation costs” include:
 - Costs to plan, design, install, construct, and purchase technology-enabled infrastructure

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Excess credit may be carried forward until used up.

No double credits:

For example, costs for which the hotel renovation credit or the capital goods excise tax credit is claimed CANNOT be claimed for this credit.

Subsection (j) actually states “No taxpayer that claims a credit under this section shall claim **any other credit under this chapter.**”

However, the definition of “net income tax liability” in this provision assumes that other credits will be taken: “net income tax liability” means income tax liability **reduced by all other credits allowed under this chapter.**

Therefore, the Department will interpret subsection (j) to mean that the **costs** for which the infrastructure credit is claimed may not be used to claim any other Hawaii income tax credit.



ACT 221 — High Tech (Continued)

- **Renovation Credit (cont.)**
 - “Technology-enabled infrastructure” means:
 - High speed telecom systems for Internet and direct satellite communications access, and videoconferencing facilities;
 - Physical security systems for these spaces;
 - Environmental systems including heating, ventilation, air conditioning, and fire detection/suppression systems; AND
 - Backup and emergency power systems.

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ACT 221 — High Tech (Continued)

- **Royalty income exclusion (§235-7.3)**
 - Deletes negative definition of a QHTB
 - Adds to the definition of “qualified research”
 - Sensor and optic technologies;
 - Ocean sciences;
 - Astronomy;
 - Nonfossil fuel energy-related technology
- **Stock option income exclusion (§235-9.5)**
 - Definition of a QHTB now same as for the royalty income exclusion in §235-7.3, HRS (replaces separate definition)

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ACT 221 — High Tech (Continued)

- High technology business investment tax credit (§235-110.9)
 - Expands the credit from 10% to 100% claimed over a 5-year period.
 - The credit is 35%, 25%, 20%, 10%, and 10% in the 1st through 5th years, respectively.
 - Subject to limitations and recapture provisions.
 - Definition of “qualified research” now same as for royalty income exclusion in §235-7.3, HRS (replaces separate definition)

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Limitations:

- Year the investment was made (year 1) – \$700,000
- 1st year following the year the investment was made (year 2) – \$500,000
- 2nd year following the year the investment was made (year 3) – \$400,000
- 3rd year following the year the investment was made (year 4) – \$200,000
- 4th year following the year the investment was made (year 5) – \$200,000

Recapture: 10% of the amount of the total tax credit claimed in the preceding 2 taxable years. Amount recaptured added to the investor/taxpayer’s tax liability for the taxable year in which the recapture occurs.

Required if at the close of any taxable year during the 5-year period:

- The business no longer qualifies as a QHTB;
- The business or an interest in the business has been sold by the investor/taxpayer; OR
- The investor/taxpayer withdraws all or part of the investment in the QHTB.

NOTE: This credit is nonrefundable. Excess credit may be carried over to subsequent years until exhausted.

NOTE: This credit contains a “drop dead” date, such that it does not apply to taxable years beginning after December 31, 2005.

Act 221 also provides that taxpayers may continue to claim this credit after December 31, 2005, IF the 5-year period to claim the credits begins prior to January 1, 2006.



ACT 221 — High Tech

(Continued)

- Sales of unused NOLs by a QHTB (§235-111.5)
 - Definition of a QHTB is the same as for the royalty income exclusion in §235-7.3, HRS.
 - Surrendered tax benefit is computed at the corporate rate for all QHTBs regardless of entity type.
 - CPA certification no longer required.
- Other technical amendments and clarifications
- Income tax provisions of Act 221 are applicable to taxable years beginning after December 31, 2000

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Note that a QHTB definition was inadvertently omitted (drafting error) in Act 297, SLH 2000, for purposes of the sale of unused NOLs. The Department previously had said that we would use the same definition used for the stock option income exemption. The reference here is to the definition used for the royalty exclusion which the stock option income exclusion now also references.



ACT 293 — Drought Mitigation

(H.B. 1074, H.D.2, S.D.2, C.D.1)

- New refundable qualified water storage facility income tax credit of 4% of the qualifying cost
- Claimed by farmers and ranchers who are not claimed or eligible to be claimed as a dependent by another taxpayer
 - “Farmers” includes both agricultural and aquacultural producers
- “Qualifying water storage facility ” means:
 - A water storage facility that is part of a conservation plan approved by the local soil and water conservation district

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ACT 293 — Drought Mitigation (Continued)

- “Qualifying costs” means:
 - Any costs incurred and paid after December 31, 2000, for the construction, repair, or reconstruction of a new or existing qualified water storage facility in the State
 - Excludes any federal or state government grants or subsidies
- Effective June 28, 2001
 - Credit available for taxable years beginning after December 31, 2000, but not for taxable years beginning after December 31, 2005

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ACT 309 — Public Schools

(S.B. 493, S.D.2, H.D.2, C.D.1)

- New nonrefundable tax credit of 10% of the value of contributions of in-kind services to the Hawaii school repair and maintenance fund
 - Credit may be claimed by contractors, architects, engineers, surveyors, landscape architects, and pest control operators licensed under chapters 444, 460J, or 464, HRS.
 - Value of contributions of in-kind services cannot exceed \$40,000 in the aggregate.
 - Credit must be claimed on or before the end of the twelfth month following the close of the tax year.

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ACT 309 — Public Schools (Continued)

- “Value of contributions of in-kind services” means:
 - The fair market value of uncompensated services or labor as determined and certified by DAGS
- DAGS must issue a certificate certifying:
 - The amount of the contribution;
 - That the taxpayer is licensed under chapter 444, 460J, or 464, HRS; AND
 - That the taxpayer has obtained a current and valid tax clearance certificate (Form A-6)

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ACT 309 — Public Schools

(Continued)

- Taxpayer must attach the certificate from DAGS to their income tax return
- Maximum amount of contribution that DAGS may certify is \$2,500,000
 - State will provide no more than \$250,000 in tax credits
- Applies to taxable years beginning after December 31, 2000
- Act 309 effective July 1, 2001

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Non-Tax Provisions:

- Creates a new Hawaii school repair and maintenance fund (separate fund of the nonprofit Helping Hands Hawaii organization).
- Legislature may appropriate monies for the fund and may impose restrictions on those monies.
- Appropriates \$500,000 for FY 2001-2002 and \$500,000 for FY 2002-2003 as a grant-in-aid. State monies must be matched by private, federal, county, or community sources. Effective July 1, 2001.



ACT 311 — School Facilities

(S.B. 1211, S.D.2, H.D.2, C.D.1)

- Establishes a new Hawaii school-level minor repairs and maintenance special fund
 - Effective July 1, 2001
- Amends §235-102.5 to authorize a new income tax check-off
 - Individuals may designate \$2 of their refund (\$4 if married filing a joint return) to go into the Hawaii school-level minor repairs and maintenance special fund.
 - Designation cannot be revoked.
 - Applicable to taxable years beginning after December 31, 2000

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IMPORTANT: The new check-off WILL affect the amount of the individual's refund; it is NOT LIKE the current \$2 Hawaii Election Campaign fund check-off.

The amount designated can be claimed as a deductible charitable donation if taxpayers itemize their deductions.

NOTE: Act 311 also amends §302A-1504 to provide for 2 (instead of 1) school-level minor repairs and maintenance accounts for each public school. The existing account is funded with general fund monies, and the new account is funded with appropriations from the Hawaii school-level minor repairs and maintenance special fund.



Miscellaneous Tax Measures

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ACT 32 — Cigarette Tax

(H.B. 518, H.D.1)

- Makes it illegal to have for sale or distribution in the State any package of cigarettes
 - That bears a brand name that is a registered U.S. trademark of a Master Settlement Agreement participant, AND
 - Was imported by someone other than that manufacturer.
- Class B felony
 - For knowingly affixing a cigarette tax stamp to a package of cigarettes that was intended for export outside the U.S. or that was illegally altered.
- Effective April 26, 2001

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ACT 64 — PSC Tax

(S.B. 1198, S.D.1)

- Effectuates an agreement entered into by and among the State, the counties, and certain public service companies providing for the sharing of PSC tax revenues with counties that exempt PSCs from real property taxes
- Allows for a transition period from July 2001 to December 2001
- Effective July 1, 2001

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ACT 143 — Fuel Tax

(H.B. 1345, H.D.1)

- Excludes alternative fuels from fuel taxes other than fuel taxes imposed for operating internal combustion engines
- Reduced fuel tax rates for alternative fuels
- Effective May 24, 2001
 - Applicable to taxable years beginning after December 31, 2001

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Alternative fuels include:

- Methanol, denatured ethanol and other alcohols, and mixtures containing 85% or more by volume of Methanol, denatured ethanol and other alcohols with gasoline or other fuels;
- Natural gas, liquefied petroleum gas, hydrogen, coal derived liquid fuels, biodiesel and mixtures containing 20% or more by volume of biodiesel with diesel or other fuels;
- Fuels other than alcohol derived from biological materials
- Any other fuels substantially not a petroleum product that the governor determines appropriate



ACT 272 — Energy

(H.B. 173, H.D.2, S.D.2, C.D.1)

- Sets renewable energy goals (renewable portfolio standards) for electric utility companies
- Allows for net energy metering
 - “Net energy metering” means measuring the difference between:
 - The electricity supplied through the electrical grid AND
 - The electricity generated by an “eligible customer-generator” and fed back to the electric grid over a monthly billing period

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“Renewable portfolio standard” is the percentage of electrical energy sales that is represented by renewable energy.

The renewable portfolio standard goals are:

- 7% of net electricity sales by December 31, 2003
- 8% of net electricity sales by December 31, 2005
- 9% of net electricity sales by December 31, 2010

An electric utility company and its electric utility affiliates may aggregate their portfolios to achieve the goals. If the company does NOT meet the goals, it must report to the PUC within 90 days to explain. PUC can grant a waiver or extend the deadline. PUC may provide incentives for exceeding the goals, attaining the goals ahead of time, or both.



ACT 272 — Energy

(Continued)

- Net Energy Metering (cont.)
 - “Eligible customer-generator” means:
 - A residential or commercial customer of an electric utility;
 - That owns and operates a solar, wind turbine, biomass, or hydroelectric energy generating facility, or a hybrid system of 2 or more of these, with a capacity of ≤ 10 kw that is:
 - Located on the customer’s premises;
 - Operated in parallel with the utility’s transmission and distribution facilities;
 - In conformance with the utility’s interconnection requirements; AND
 - Intended primarily to offset part or all of the customer’s own electrical requirements.

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ACT 272 — Energy

(Continued)

- Net Energy Metering (cont.)
 - Electric utilities may enter into contracts with eligible customer-generators so that:
 - Excess electricity generated and fed back into the system offsets customer's cost of electricity furnished by the utility; AND
 - Excess electricity generated and fed back into the system that is MORE THAN the customer's cost of electricity furnished by the utility can be purchased by the utility.
 - Tax Implications:
 - More taxpayers claiming the energy conservation tax credit on income tax returns.

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Note that Act 272 does NOT require the electric utility to pay for the excess kilowatt hours generated although it may enter into a purchase agreement with the eligible customer generator.

